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University of Toronto

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University of Toronto

Rationale

Issuer Credit Rating
AA/Stable/--

The ratings on the University of Toronto reflect the university's stand-alone credit profile (SACP), which Standard & Poor's Ratings Services assesses at 'aa'. The ratings also reflect our opinion of a "moderately high" likelihood that the Ontario government would provide extraordinary support in the event of financial distress.

The SACP on UofT reflects Standard & Poor's view of the university's strong enrollment and student demand profile, solid consolidated financial performance, and robust financial resources. In our opinion, UofT's substantial-but-stable postemployment liabilities, and a significant debt offset some of these strengths.

In accordance with our criteria for government-related entities, our view of the university's moderately high likelihood of extraordinary government support reflects our assessment of its "important" role in the province, given that postsecondary education is one of Ontario's priorities in both expenditure and mandate (after health care and school boards), and that there are no viable private alternatives. It also reflects our assessment of UofT's role as Canada's largest university in enrollment and research capacity. The province's oversight, program approval rights, and tuition regulation over the university suggest a "strong" link to it. We rate UofT 'AA' in line with the 'aa' SACP, which is higher than the rating on the province, because the independence of the university's governing bodies, its considerable financial resources, and a track record of non-interference from the province convince us that there is a measurable likelihood that it would not default on its obligations under a short-lived provincial default scenario in which all government funding was temporarily disrupted.

UofT's credit profile benefits from healthy and stable demand and enrollment, in our opinion. The university's full-time equivalent students (FTEs) increased 2.9% to 72,370 in fiscal 2014, supported by growth in both graduate and undergraduate enrollment. This was in line with the five-year average of 2.8%. Student quality metrics continued to be strong, in our view. The acceptance rate (offers-to-applicants) and the matriculation rate were 53% and 32%, respectively, in fiscal 2014, in line with the five-year averages. The average entry grade was unchanged from the previous year, at 85%, while retention and graduation rates gained one percentage point each to 92% and 72%, respectively, in fiscal 2014. Overall, the university's student quality metrics compare well with those of similarly rated Canadian peers.

Higher student demand and more prudent divisional spending contributed to improved consolidated financial results in fiscal 2014. UofT's consolidated surplus was 8.2% of total adjusted expenses, up from 5.7% in fiscal 2013, by our estimates. Adjusted for noncash items related to changes in the fair value of investments and employee future benefits (but including amortization and depreciation revenues and expenses), the university recorded a modified accrual surplus of 3.7% of adjusted operating expenses, below the 5.3% of the previous year. Although UofT has budgeted for balanced operating results for fiscal years 2015 and 2016, we believe it will continue recording consolidated surpluses.

We believe the university's substantial postemployment liabilities constrain the ratings somewhat. At UofT's most recent actuarial valuation (July 1, 2014) for its registered pension plan, the defined benefit pension deficit was C$697 million on a going-concern basis, down 27% from C$957 million at the previous actuarial valuation (July 1, 2011), mostly due to very positive investment returns and employer special payments, which actuarial assumptions changes partially offset. The solvency deficit remained essentially unchanged at July 1, 2014, from the previous actuarial valuation, at slightly more than C$1 billion, largely because of lower interest rates. Following the university's acceptance in the province's stage 2 solvency relief, it can defer the start for its solvency payments for three additional years, until July 1, 2018. It will have to amortize any solvency deficit as of 2018 over seven years (the remaining period in the original 10-year amortization period) until July 1, 2025. Under the current pension contribution strategy, UofT estimates its annual special pension payments budget, which includes estimated pension special payments and other related costs, will be C$92.3 million in fiscal 2015, rising C$5 million per year to C$112.3 million in fiscal 2019; it will remain at this level afterward.

The debt burden remains significant, in our opinion. Total debt stood at C$723 million in fiscal 2014, virtually unchanged from the previous year-end. It represented 27.3% of adjusted operating expenses, which was slightly below fiscal 2013's 30.3%. Debt-to-FTE also declined modestly, to C$9,988 in fiscal 2014, which was due to higher FTE numbers. We consider the university's debt burden to be manageable and broadly in line with that of peers. With no debt issuance expected in the next two years, UofT's debt metrics should improve with rising enrollment and total expenses. We expect debt should fall close to 25% of adjusted operating expenses and C$9,500 per FTE by fiscal year-end 2017.

We have used the "Principles Of Credit Ratings" in conjunction with "U.S. Public Finance: Higher Education" as our criteria foundation for our analysis of UofT's creditworthiness. We feel that there is a sufficient degree of similarity between U.S. and Canadian public university systems such that we believe the U.S. higher education criteria is an appropriate methodology for evaluating Canadian universities' credit quality.

Liquidity

UofT has the largest endowment among Canadian universities, with a fair value of C$1.9 billion as of the end of April 2014. The endowment has significantly increased in the past 10 years, by about 32% since 2005. Consolidated cash and investments totaled C$3.4 billion, up 6.6% from fiscal 2013. Total cash and investments represented 127% of adjusted operating expenditures, or 4.6x total debt. Unrestricted financial resources (internally restricted net assets and internally restricted endowments) stood at C$1.1 billion, up from C$933 million in fiscal 2013. This equaled about 146% of debt and 40% of adjusted operating expenses. We expect that the university will maintain strong liquidity to support its debt burden throughout the outlook horizon.

Outlook

The stable outlook reflects Standard & Poor's expectations that, within our two-year outlook horizon, UofT will maintain its strong student demand profile, its operating budgets will remain balanced, and its debt burden will decline modestly or be stable. We could revise the outlook to negative or lower the ratings if operating deficits were to emerge as result of a significant reduction in government grants or substantial pressure from rising pension deficits, or if the debt burden were to increase considerably. Significantly reduced unfunded postemployment liabilities, a substantial decline in debt, or a material rise in unrestricted financial resources could result in an upward revision to the outlook or ratings.

Government-Related Entities Methodology: Moderately High Likelihood Of Extraordinary Provincial Government Support

In accordance with our criteria for government-related entities, our view of UofT's moderately high likelihood of extraordinary government support reflects our assessment of its important role in the province, given that postsecondary education is one of Ontario's priorities in both expenditure and mandate (after health care and school boards), and that there are no viable private alternatives. It also reflects our assessment of the university's role as Canada's largest university in enrollment and research capacity. The province's oversight, program approval rights, and tuition regulation over UofT suggests a strong link to it. Also supporting the link is the university receiving 26% of total revenues from provincial operating grants, and the province's appointment of some board members. Although Ontario is facing significant fiscal challenges and projects large provincial deficits in the medium term, we believe that postsecondary education will remain a top priority for the province and that overall support for the university sector will be stable.

Following our "USPF Criteria: Higher Education" and "Principles Of Credit Ratings" criteria, we have assessed UofT's SACP at 'aa'. We rate the university 'AA' in line with the 'aa' SACP, one notch higher than the rating on the province. This is because the independence of UofT's governing bodies, its considerable financial resources, and a track record of non-interference from the province convince us that it is likely the university would not default on its obligations in a short-lived provincial default in which all government funding was temporarily disrupted.

Enterprise Profile

Background

Founded in 1827, UofT is Canada's largest university based on enrollment and has three campuses (St. George, Scarborough, and Mississauga) that together accounted for about 85,000 students in fall 2014. The university offers a variety of undergraduate, graduate, postgraduate, and professional degrees across its 18 faculties and schools. It also has affiliations with seven colleges, 65 centers and institutes, and nine Toronto hospitals. UofT employs more faculty and staff and offers a greater range of courses than any other Canadian university. It is also Canada's most important research institution and has gained an international reputation for its research.

Management

A 50-member board governs the university. The province appoints 16 of the 50 governors. The board appoints the president, senior administrators, and senior staff. The board's decisions include approval of strategic plans, academic programs, budgets, capital expansion, fundraising research, and employment policies.

In March 2013, the university elected a new president for a five-year term. He has been with UofT for the past three decades. Recent changes in the senior management team include the appointment of a vice-president at UofT Scarborough, a vice-president of research and innovation, and a vice-president of communications. We expect the team to be stable in the next two years. The university prepares externally audited financial statements, which have been unqualified, and operating and capital budget documents and policies are robust and transparent. It approves annually a five-year operating budget that is aligned with its strategic plan. It also has a number of transparent and robust financial policies in place, including investment policies and a new debt policy.

High demand and student quality

We believe UofT's credit profile benefits from healthy and stable demand and enrollment. The university's full-time equivalent students (FTEs) increased 2.9% to 72,370 in fiscal 2014, with growth in both graduate and undergraduate enrollment. UofT projects that its graduate students, which historically represented about 20% of the total student population, will increase to 22.3% by fall 2017. It expects most of the increase to be at its largest campus (St. George) and will be primarily domestic. The university expects to increase undergraduate enrollment at its Scarborough and Mississauga campuses, with 43% of this coming from international students. International enrollment, which has been rising steadily, should reach more than 18% by fiscal 2017. We believe that the province's commitment to fund more than 40,000 new university spaces and expected stable growth in the Greater Toronto Area's university-age population (about 64% of UofT's student intake comes from the area) in the next five years should help the university achieve its growth targets.

Student quality metrics continued to be strong in fiscal 2014, in our opinion. The acceptance rate (offers-to-applicants) and the matriculation rate were 53% and 32%, respectively, in fiscal 2014, in line with the five-year averages. The average entry grade and the retention rate of first-year students were 85% and 92%, respectively; these were stable in the past five years. The graduation rate improved slightly to 72%, from 71% a year earlier. Overall, UofT's student quality metrics compare well with those of similarly rated Canadian peers.

Financial Profile

Financial results remain strong in fiscal 2014

The university posted a consolidated surplus of 8.2% of total adjusted expenses in fiscal 2014, up from 5.7% in fiscal 2013, by our estimates. Adjusted for noncash items related to changes in the fair value of investments and employee future benefits (but including amortization and depreciation revenues and expenses), the university recorded a modified accrual surplus of 3.7% of adjusted operating expenses, below the 5.3% of the previous year.

Total expenses rose 3.0% in fiscal 2014, with increases in all expense areas. Salary and benefit costs are UofT's biggest expenditure; they represent about 61% of total expenses in fiscal 2014 and continue to be its biggest source of budgetary pressure, as is the case with all other rated Canadian universities. They increased 5.5% in fiscal 2014, reflecting negotiated pay raises and more faculty and staff; other non-employee-related costs rose 3.8%.

Total revenues increased 5.7% in fiscal 2014 on higher student fees, investment income, donations, and other income. The rise in student fees, the largest single revenue increase, was due in most part to higher enrollment; the increase in investment income was the result of better investment returns. Total government grants were relatively stable in fiscal 2014. A slight decrease in research and restricted purpose grants offset modest growth in operating grants. Government grants are UofT's biggest revenue source, representing about 40% of total revenues in fiscal 2014, followed by student fees, at 38%. Ontario operating grants represented 26% of the university's total revenues. We do not expect revenues to increase strongly in the next two years. The provincial government has capped tuition increases at 3% (for domestic undergraduate students) annually and its own deficits will constrain its ability to provide increased support for universities in the province. However, UofT's strategy of increasing international enrollment could provide some uplift to revenues, given that tuition for international students remains unregulated. On the other hand, we think it is unlikely that provincial operating grants will decline significantly in the next two years, given postsecondary education's vital public role.

The university has relieved some pressure on its operating budget after having made two lump sum pension contributions (totaling C$300 million) to its registered plans. Furthermore, under the amended provincial solvency funding relief program, UofT will defer its solvency deficit payments to July 1, 2018, from July 1, 2015, as previously expected, which should provide some budgetary flexibility in the near term. On top of its previously budgeted special pension payments increases, UofT has allocated an extra C$5 million per year until fiscal 2019, increasing its total special pension payments budget to C$112.2 million from C$97.2 million in fiscal 2016. The university estimates this is adequate to cover special payments and associated costs for the next three years.

According to the university's fiscal 2016 budget, operating results will be balanced for fiscal years 2016-2020. The budget assumes that domestic undergraduate tuition fee growth will be capped at 3% over the five-year budget period and growth in government operating grants will be minor. Nevertheless, operating revenues are forecast to rise at an annual average rate of about 5%. With the forecast balanced results, expenditures should rise at the same rate as revenues in the five-year period, with academic expenses accounting for the majority of budgeted operating expense growth.

Solvency relief moderates near term special pension payments

UofT has several defined benefits plans that provide pension and other postemployment benefits to its employees. As of the most recent actuarial valuation for its UofT registered pension plan (July 1, 2014), the defined benefit pension deficit was about C$697 million on a going-concern basis, down 27% from C$957 million at the previous valuation (July 1, 2011). This was the result of a combination of excellent investment returns and employer special payments, which actuarial assumptions changes partially offset. The solvency deficit was essentially unchanged at July 1, 2014, at slightly more than C$1 billion, largely because of lower interest rates.

As of April 30, 2014, the pension plan accounting deficit was C$683.8 million, down 39% from C$1.12 billion the previous year. UofT also had a C$514.4 million nonpension postemployment deficit (on an accounting basis). Nonpension postemployment benefits include medical and dental coverage and long-term disability. Because there is no legislative requirement to maintain assets against these liabilities (unlike pensions), the university funds these on a pay-as-you-go basis, similar to other universities.

The university made all the required pension contributions for the pension fiscal year ending June 30, 2014: a second C$150 million lump sum payment (financed through C$121.8 million assets from the Supplemental Retirement Arrangement, and C$28.2 million approved internal borrowing), C$94.6 million employer current service funding, and C$101 million employer special payment funding.

In early 2015, UofT received acceptance for stage 2 of Ontario's solvency relief, which the province has recently refined. This will allow the university to defer the start for its net solvency payments for three additional years, to July

1, 2018. It will have to amortize any solvency deficit as of 2018 over seven years (the remaining period in the original 10-year amortization period) until July 1, 2025. As a result, it estimates that the annual solvency special payments under the amended stage 2 solvency relief will be C$58.7 million. The annual going-concern special payments will total C$78.7 million for the 15-year period beginning July 1, 2015.

The provincial government is studying initiatives regarding a university sector-wide jointly sponsored pension plan. In addition, UofT is also considering creating its own internal jointly sponsored plan. Although we see these initiatives as positive, they are forward-looking and would not address the going-concern and solvency deficits.

Construction activity will slow down

In fiscal 2014, capital expenditures totaled C$252 million, up 23% from fiscal 2013. The majority was for buildings and equipment and furnishings (more than 80%), with the remainder going to library books. With the completion of the PanAm Aquatics and Athletics Centre, UofT estimates that its construction activity will slow in 2015. Major projects will primarily include building the Environmental Sciences & Chemistry building on the Scarborough campus, the relocation of the John H. Daniels Faculty of Architecture, Landscape & Design, and the Faculty of Law expansion and renovation. Funding sources will primarily be operating funds, government grants, and the capital campaign.

The university's deferred maintenance liability, including asbestos containment and removal, was C$615 million in fiscal 2014. Its fiscal 2016 budget includes C$15 million annually, rising to C$18 million in a few years, to address deferred maintenance at St. George (estimated at C$435 million), with additional funds for the Mississauga and Scarborough campuses. The university's portion of provincial funding will increase to C$12 million in fiscal 2020 from C$3 million in fiscal 2015; it also charges departments for the space they use, encouraging more effective use of space and helping contain costs.

Financial resources continue to grow

UofT has the largest endowment among Canadian universities, with a fair value of C$1.88 billion, at April 30, 2014. It has significantly increased in the past 10 years, by about 32% since 2005. The university has a conservative endowment draw, in our view, with an annual spending rate of 3.0%-5.0% of the opening market value of the endowments. In fiscal 2014, the endowments paid out C$72.6 million, which represented 4.4% of total endowments.

At fiscal year-end 2014, consolidated cash and investments totaled C$3.36 billion, up 6.4% from fiscal 2013. Total cash and investments represented 127% of adjusted operating expenditures, or more than 4.6x total debt. Unrestricted financial resources (internally restricted net assets and internally restricted endowments) stood at C$1.1 billion which was up from the previous year's total of C$933 million. This equaled about 146% of debt and 40% of adjusted operating expenses.

UofT's investment portfolios in fiscal 2014 included 54% of fixed-income securities, 42.3% of Canadian and international equities, and 3.4% of cash. The endowment fund's annual return (net of investment fees and expenses) was 14.6%, which was a net improvement from the previous year's return of 11.4% and 6% target return. Endowment per FTE has also strengthened significantly; in 2014, it was close to C$26,000.

Significant-but-manageable debt burden

Total gross debt outstanding stood at C$723 million at fiscal year-end 2013, virtually unchanged from the previous year. The debt represented 27.3% of adjusted operating expenses and C$9,988 per FTE, down slightly thanks to higher FTE numbers. These levels are broadly in line with those of key peers such as University of Western Ontario and Queen's University, but higher than those of University of British Columbia.

Removing the impact of noncash amortization and depreciation revenues and expenses, the adjusted debt service coverage ratio in fiscal 2014 was 5.3x. Interest expense was a modest 1.5% of adjusted expense. These ratios compare well with those of UofT's domestic peers and we expect that they will remain near current levels.

With no debt issuance expected in the next two years, the university's debt metrics should improve with rising revenues and enrollment. We expect that debt should fall below 25% of adjusted operating expense and C$9,500 per FTE by fiscal year-end 2017.

Most of the UofT's debt consists of fixed-rate, bullet debentures, which it uses mainly to finance capital projects. To repay its debt, the university sets aside principal payments from academic divisions into a self-imposed sinking fund (the long-term borrowing pool). In fiscal 2014, these assets totaled C$166.7 million; they are invested together with the endowment fund.

In November 2012, UofT's business board approved a new debt strategy that sets what we view as prudent debt limits. This increases the university's external debt limit to C$1.4 million for fiscal 2014, of which C$1 billion is external. UofT's debt outstanding, external and internal, is well within the two limits. We do not expect the university to issue any external debt in the next two years.

Fundraising

As of Dec. 31, 2014, the university and its affiliated federated universities have received C$1.65 billion in receipts and pledges as part of a C$2.0 billion fundraising campaign launched in 2011. Out of the C$201 million raised in 2013-2014, the Rogers family has pledge C$130 million to fund the creation of the Ted Rogers Centre for Heart Research at the University of Toronto, the Hospital for Sick Children, and the University Health Network.

The majority of the funds raised under this campaign will likely have external restrictions, which tends to be the case for about 85% of UofT's total endowment. However, we believe that even these provide strength, by producing spendable endowment income. Furthermore, endowments restricted for scholarships or faculty chairs enhance a university's profile, attracting quality students and faculty. At fiscal year-end 2014, UofT's total endowments were C$1.88 billion.

University of Toronto -- Peer Comparison

	--University of Toronto--		--University of British Columbia--		--Queen's University--		--University of Western Ontario--	
	2014	2013	2014	2013	2014	2013	2014	2013
Rating at Dec. 31	AA/Stable/--	AA/Stable/--	AA+/Stable/--	AA+/Stable/--	AA+/Stable/--	AA+/Stable/--	AA/Stable/--	AA/Stable/--

University of Toronto -- Peer Comparison (cont.)

Enrollment and demand								
Full-time equivalent (FTE)	72,370	70,311	50,745	50,149	22,443	21,904	31,448	31,018
Acceptance rate (%)	53	51	48	48	42	41	51	51
Matriculation rate (%)	32	34	54	54	41	43	21	22
Undergraduate FTEs as % of total FTEs	80	80	83	83	83	82	80	80
Income statement								
Adjusted operating revenues (C$000s)	2,742,900	2,523,400	2,151,516	2,113,275	807,415	782,858	1,096,838	1,049,744
Adjusted operating expenses (C$000s)	2,644,800	2,395,600	2,127,346	2,052,284	795,193	776,298	1,044,229	987,065
Estimated operating gain / loss as % of operating expenses (%)	3.7	5.3	1.1	3.0	1.5	0.8	5.0	6.4
Tuition and student fee dependence (% of adjusted revenues)	37.9	37.4	22.1	20.8	30.4	29.8	30.3	29.4
Debt								
Debt outstanding (C$000s)	722,800	726,000	373,622	379,475	224,683	221,074	310,290	316,185
Current debt service burden (% of adjusted expenses)	1.5	1.7	1.3	1.2	2.0	2.4	2.3	1.8
Financial resource ratios								
Total endowment (C$000s)	1,880,800	1,663,700	1,321,861	1,166,994	800,238	710,251	509,659	431,853
Cash and investments (C$000s)	3,359,500	3,158,700	959,029	848,445	1,116,892	977,889	1,199,212	1,074,178
Adjusted unrestricted financial resources (UFR; C$000s)*	1,053,900	932,700	492,706	363,566	425,569	375,928	496,213	391,981
Cash and investments to adjusted expenses (%)	127.0	131.9	45.1	41.3	140.5	126.0	114.8	108.8

University of Toronto -- Peer Comparison (cont.)								
Cash and investments to debt (%)	464.8	435.1	256.7	223.6	497.1	442.3	386.5	339.7
Adjusted UFR to adjusted expenses (%)	39.8	38.9	23.2	17.7	53.5	48.4	47.5	39.7
Adjusted UFR to debt (%)	145.8	128.5	131.9	95.8	189.4	170.0	159.9	124.0
Unfunded pension and other postemployment liabilities to total liabilities (%)	31.7	42.9	0.3	0.4	7.0	14.5	26.0	24.4

*Adjusted UFR: adjusted internally restricted net assets plus internally restricted endowments.

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Principles Of Credit Ratings, Feb. 16, 2011
- USPF Criteria: Higher Education, June 19, 2007

Ratings Detail (As Of May 4, 2015)	
University of Toronto	
Issuer Credit Rating	AA/Stable/--
Senior Unsecured	AA
Issuer Credit Ratings History	
22-Mar-2013	AA/Stable/--
17-Mar-2011	AA/Negative/--
26-Sep-2003	AA/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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